DEPARTMENT OF STATE REVENUE

01-20190151.LOF

Letter of Findings: 01-20190151
Individual Income Tax
For the Year 2014 and 2015

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Restaurant Partners failed to establish that the Department erred in assessing additional individual income tax based on income which "flowed through" from their Indiana restaurant business.

ISSUE

I. Individual Income Tax - Partnership Income.

Authority: IC § 6-3-4-11; IC § 6-8.1-5-1(c); *Indiana Dep't of State Revenue v. Caterpillar, Inc*., 15 N.E.3d 579 (Ind. 2014); *Indiana Dep't of State Revenue v. Rent-A-Center East*, Inc., 963 N.E.2d 463 (Ind. 2012); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin*., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayers argue that the Department erred in assessing additional individual income tax based on income attributable to their Indiana restaurant business.

STATEMENT OF FACTS

Taxpayers are Indiana residents reporting their income on an Indiana IT-40. Taxpayers are the shareholder/partners of an Indiana restaurant business. The Indiana Department of Revenue ("Department") conducted a sales and income tax audit of Taxpayers' restaurant business. That audit found discrepancies in the restaurant's business records for the years 2014 and 2015.

The Department concluded that the restaurant received more income than originally reported. The restaurant's audit report explained that because the restaurant was operated as a partnership, "the partnership income flow[ed] through to the shareholder's/partner's individual return."

Taxpayers - as the restaurant partners - disagreed with the assessment of additional Indiana individual income tax and submitted a protest to that effect. This Letter of Findings results.

I. Individual Income Tax - Partnership Income.

DISCUSSION

The issue is whether Taxpayers have provided sufficient documentation to establish that the Department erred when it assessed Taxpayers additional Indiana income tax.

Because the audit resulted in an assessment of additional tax, it becomes the Taxpayers' responsibility to establish that the assessment including interest, penalty, and tax is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East*, Inc., 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

When a taxpayer challenges taxability in a specific instance, that taxpayer is required to provide documentation explaining and supporting its challenge. Poorly developed and non-cogent arguments are subject to waiver.

Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

Partners are responsible for reporting and paying income tax based on their interest in a partnership. IC § 6-3-4-11 provides:

> (a) A partnership as such shall not be subject to the adjusted gross income tax imposed by IC 6-3-1 through IC 6-3-7. Persons or corporations carrying on business as partners *shall be liable for the adjusted gross income tax only in their separate or individual capacities*. In determining each partner's adjusted gross income, such partner shall take into account his or its distributive share of the adjustments provided for in IC [§] 6-3-1-3.5.
>
> (b) The adjustments provided for in IC [§] 6-3-1-3.5 shall be allowed for the taxable year of the partner within or with which the partnership's taxable year ends.

(*Emphasis added*).

In this case, Taxpayers' assessment is attributed to the Department's audit of Taxpayers' restaurant business. The audit found "variances" between the gross receipts reported on the restaurant's 2014 and 2015 form 1065 ("U.S. Return of Partnership Income") and the restaurant's 2014 and 2015 bank deposits. As explained in the restaurant's audit report:

> The total [bank] deposits deemed as business related deposits were greater than the gross receipts reported; therefore, the variances are being assessed as unreported taxable revenues.

However, Taxpayers argue that the restaurant's audit misunderstood and/or misrepresented the information contained in their restaurant bank records. Taxpayers state that the Department made "typographical errors," that the restaurant audit categorized amounts of personal income as income attributable to the restaurant, that exempt restaurant sales were reported as restaurant income, and that the Department included sales tax collected from their restaurant customers as restaurant income.

However, Taxpayer believes that the "biggest problem was in 2014 and 2015" where the audit imputed additional income based on otherwise exempt restaurant sales. To that end, Taxpayer included restaurant receipts intended to establish that some of its restaurant customers were exempt entities. For example, Taxpayer included receipts for food sold to "Forestry and Natural Resources," to a university women's soccer team, to an education association, and to an adult education organization.

However, Taxpayers are mixing apples and oranges. Taxpayers are conflating sales tax with income tax. The fact that a restaurant transaction may be exempt from sales tax does not necessarily result in the money received from such a transaction being exempt from income tax. In this instance, the issue raised by Taxpayers stems from the assessment of additional individual income tax; Taxpayers' rebuttal is that a certain amount of its restaurant sales were made to exempt organizations such as university organizations. Assuming for the moment that these restaurant customers were entitled to pay for dining expenses without paying sales tax - a dubious notion - Taxpayers have not established how that purported discrepancy would have affected the amount of income which did or did not flow through to their individual benefit as shareholder/partners.

Taxpayers have failed to meet their statutory burden under IC § 6-8.1-5-1(c) of establishing that the assessment of additional income tax was wrong. Taxpayers have raised concerns and questions but have not sufficiently explained or developed those concerns. Taxpayers have not established that the assessment was incorrect.

FINDING

Taxpayers' protest is respectfully denied.

July 19, 2019

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An html version of this document.